

UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

IN RE: Chapter 11
Case No. 22-11068 (JTD)
FTX TRADING LTD. *et al.*,
Debtors. (Jointly Administered)
.
.
FTX TRADING LTD., MACLAURIN Adversary Proceeding
INVESTMENTS LTD., f/k/a/ No. 23-50492 (JTD)
ALAMEDA VENTURES LTD., and
WEST REALM SHIRES SERVICES,
INC.,
Plaintiffs,
-against-
LAYERZERO LABS LTD., ARI
LITAN, and SKIP & GOOSE Courtroom No. 5
LLC, 824 Market Street
Wilmington, Delaware 19801
Defendants.
Wednesday, December 13, 2023
1:05 p.m.

TRANSCRIPT OF HEARING
BEFORE THE HONORABLE JOHN T. DORSEY
UNITED STATES BANKRUPTCY JUDGE

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1 (Proceedings commenced at 1:02 p.m.)

2 THE COURT: Good afternoon, everyone. Thank you.
3 Please be seated.

4 Mr. Landis.

5 MR. LANDIS: Good afternoon, Your Honor. May it
6 please the Court, Adam Landis from Landis Rath & Cobb on
7 behalf of FTX Trading Ltd., and its affiliated debtors.

8 Your Honor, we filed our agenda at Docket 4601 on
9 December 11th. Although there is a number of items on the
10 agenda, Items 1 through 5 have been adjourned. Items 6
11 through 13 and 15 have been resolved with orders entered or
12 orders pending. We are grateful to Your Honor for entering
13 those orders.

14 That leaves us with one matter going forward
15 today, Agenda Item No. 14, which is the debtors' motion to
16 establish the schedule and procedures for the estimation of
17 the Department of Treasury - IRS claims. In connection with
18 that matter Mr. Bromley will make the presentation on behalf
19 of the debtors.

20 THE COURT: Okay. Thank you.

21 MR. BROMLEY: Good afternoon, Your Honor. James
22 Bromley of Sullivan & Cromwell on behalf of the FTX debtors.
23 Nice to be before you again.

24 Your Honor, this is an important issue that we are
25 bringing before you today. We have a dispute. We have a

1 dispute with the Internal Revenue Service that is potentially
2 the most material dispute that the debtors have. We have the
3 Internal Revenue Service having filed against the FTX
4 debtors' claims in the amount of \$24 billion. The filing of
5 those claims, Your Honor, creates an obstacle, a potentially
6 insurmountable obstacle, with respect to the resolution of
7 these cases.

8 And if I can start with a little bit of background
9 to lead you to where we are today, I think that might be
10 helpful.

11 THE COURT: Okay.

12 MR. BROMLEY: Your Honor may recall that these
13 cases filed very abruptly on November 11th, 2022. What we
14 found, when these cases filed, was quite remarkable. A lot
15 has been written and spoken about the circumstances of the
16 filing and the condition of the books and records of the
17 debtors at the time of the filing.

18 One of the things that hasn't been focused on as
19 much though is that when these cases filed we, effectively,
20 had a financial services firm that had a community of
21 customers all around the world that found all of their
22 deposits, their claims, their accounts frozen. In a bank
23 insolvency or broker/dealer insolvency, even an insurance
24 company insolvency which will be dealt with in State Court,
25 there are very specific provisions in the laws that deal with

1 customer and depositor claims.

2 Indeed, in most financial services insolvencies
3 customers have their claims addressed immediately and don't
4 find themselves subject to reconciliation in a Court
5 proceeding. I am handling the Chapter 11 proceedings for
6 Silicon Valley Bank Financial Group, the holding company for
7 Silicon Valley Bank. All of the customers were taken care of
8 by the FDIC and through the sale of SVB to First Citizens
9 Bank. So, all those customers of the bank, and that was the
10 case in Washington Mutual and Lehman Brothers; those
11 customers were all taken care of.

12 So, why is it different here? Well, this was a --
13 this is a new type of company. It's a new world. The crypto
14 customers, the depositors, who have filed, in these cases,
15 claims amounting to \$16 billion have been held in limbo.
16 There is no institutional or statutory regime that allows
17 them to be paid out early. There is no statutory regime that
18 provides them with particular protections.

19 What we have is a system that we have been using
20 through the Chapter 11 process to come to a resolution as
21 quickly as humanly possible to be able to compensate and
22 repay the victims of the fraud that occurred here. We have
23 been trying to do this at lightning speed. One year ago
24 today, John Ray, the CEO of these FTX entities, was sitting
25 in front of the house financial services committee testifying

1 on Capitol Hill. One year ago yesterday Sam Bankman-Fried was
2 arrested in the Bahamas subject to extradition to the United
3 States.

4 Just one year ago today we were standing in front
5 of and sitting in Congress with Mr. Ray testifying. Yet,
6 just one year later Mr. Bankman-Fried has been convicted
7 after a long trial. The Federal Government, through the
8 efficient offices of the Southern District of New York, were
9 able to put together a massive case, investigate and
10 prosecute not only Mr. Bankman-Fried, but obtain guilty pleas
11 from several other of the leaders of the organizations.

12 We are on the precipice of filing a plan of
13 reorganization, disclosure statement, and a motion for the
14 approval of solicitation procedures. A set of three
15 extraordinarily complex documents that are the result of an
16 enormous amount of work that has been put in by the debtors,
17 by the creditors committee, by the ad hoc committee, and by
18 the joint provisional liquidators where we are coming to the
19 Court, literally this weekend, with papers that represent an
20 enormous amount of consensual work and a process that will be
21 able to be implemented in the new year that will lead to the
22 delivery of recoveries to the victims of Mr. Bankman-Fried's
23 crimes.

24 There is, however, an enormous obstacle to that
25 and it is the claim that has been filed or the claims that

1 have been filed by the Internal Revenue Service. It is
2 impossible, Your Honor, to really disconnect the two. In
3 order for us, as the debtors, together with our creditor
4 constituencies and working hand and glove, and Your Honor
5 knows that wasn't easy, with the now joint official
6 liquidators of the Bahamas entity we are in a position to
7 implement a comprehensive plan of reorganization that will
8 provide for distributions to victims.

9 It's important, in our view, because when you are
10 looking at typical Chapter 11 proceedings, large liquidations
11 that take place over a period of years, whether it was Lehman
12 Brothers, or Residential Capital, or Nortel, proceedings that
13 were largely about institutional claims. There wasn't a
14 universe of victims of customers that literally were
15 depending on the recoveries to come out the door and into
16 their pockets so that they can restart their economic lives
17 which have been held simply frozen since the first week of
18 November in 2022.

19 The team of professionals that has been running
20 this exercise has received an enormous amount of criticism in
21 the press, in Congress, in papers that have been filed by
22 different parts of the United States Government for the
23 amount of money and the time that has been spent on trying to
24 bring all of this information together.

25 One of the things that we needed to do was to

1 create the financial system to understand the information
2 that had been left by Mr. Bankman-Fried and his cohorts and
3 to be able to implement a plan of reorganization and a path
4 forward. Its cost a lot of money, there is no doubt, but it
5 has worked. So, while the Internal Revenue Service, in their
6 papers, says Mr. Ray said that a year ago he has never seen
7 anything as bad as this and he has seen some bad things. He
8 has said this is a dumpster fire. It's a crime scene. These
9 are comments that were made a year ago.

10 In the time since then enormous efforts have been
11 made, substantial reports have been filed about malfeasance
12 that has taken place, enormous claims have been brought and
13 many successfully resolved in terms of bringing cash into
14 these estates. The billions of dollars that have been
15 recovered in the one-year period is really unprecedented.

16 One of the things that the debtors have done over
17 that period of time is work with the most sophisticated
18 financial advisors in the world. There aren't many cases
19 that you can say we have hired both AlixPartners and
20 Alvarez & Marsal. But not only have we hired both of them,
21 we also have Ernst & Young who have worked tirelessly with
22 respect to tax returns.

23 The issues that we are facing today, Your Honor,
24 and the relief that we are seeking isn't something that we
25 just stumbled upon in the last couple of months. From the

1 very early stages of these cases it was Mr. Ray's instruction
2 that we needed to be on top of getting a handle on the taxes,
3 filing tax returns, and making sure that those tax returns
4 were credible, bullet proof and able to be defended because
5 we expected that the internal revenue service would want to
6 take a look at it.

7 It's also important, Your Honor, to understand the
8 nature of these cases, these entities. The vast majority of
9 the business that was conducted by the FTX.com exchange, as
10 Your Honor will recall from many hearings, but in particular
11 the first day hearing when we had the structures put up on
12 the wall, took place outside of the United States. The
13 FTX.com exchange was an international exchange. You couldn't
14 operate on the FTX.com exchange if you were an American
15 citizen.

16 One of the things that the company did do
17 correctly, generally, was KYC because if you were an American
18 citizen or sitting in the United States you couldn't operate
19 on the FTX.com exchange. There was the FTXUS.com exchange.
20 That was for American citizens.

21 The vast majority of the activity that took place
22 with these debtors only took place in the last three years.
23 That is important to keep in mind because when you look at
24 Mr. Mosley's declaration, and we will talk about that a
25 little bit more, he makes it clear that FTX Trading Ltd., the

1 Antiguan entity that operated the international exchange, is
2 really the only entity in the entire group that actually
3 earned any revenue taxable income, but it's an Antiguan
4 entity not subject to tax in the United States. And even
5 taking that into account, it had one year where it earned
6 taxable revenue in Antigua over \$300 million.

7 The tax returns that we have filed for the US
8 taxpayers make it clear that there was never any taxable
9 income in the United States. Instead, there were \$11 billion
10 of losses. \$11 billion of losses because, as we know, as
11 Mr. Bankman-Fried and his cohorts stole money from clients
12 and used it to make investments they were also using it to
13 trade and they were doing a terrible job at it, and they were
14 losing lots of money on the trades. The losses on those
15 trades generated the \$11 billion of losses that are
16 represented in the tax returns that have been filed and
17 prepared by Ernst & Young.

18 What we are talking about, Your Honor, is the need
19 at this point in time to recognize that if we are going to
20 need to sit down and litigate to a point of certainty,
21 counting the sands in the Sahara Desert and boiling the ocean
22 like the IRS would suggest, the only result that we are going
23 to end up with is being able to say that instead of an \$11
24 billion loss there is a \$10 and a half billion loss or maybe
25 it's a \$13 billion loss. There is simply no credible set of

1 facts or circumstances that the IRS has put forth that could
2 in a million years, and I use that excessive phrase carefully
3 here, that could ever generate taxable income that would
4 justify a \$24 billion claim.

5 If we have a \$24 billion claim in these cases all
6 of the work that has been done to put together the plan of
7 reorganization, put together the disclosure statement,
8 structure the compensation of the tens of thousands, the
9 millions of victims here, all of that is going to have to be
10 put on a shelf until we deal with the issues that have been
11 raised by the sheer magnitude of the IRS. That is why we are
12 here today, Your Honor.

13 So, what about the IRS claim? I think what we need
14 to do is start with just Form 410, it's a proof of claim.
15 What has the IRS done? The IRS, like every other creditor,
16 must submit a proof of claim. We can't lose sight of the fact
17 of the title of that document. It is an official form. At
18 the top it says proof of claim. It doesn't take a lawyer to
19 understand that when you submit the claim you must supply
20 proof. The Internal Revenue Service has not done that.
21 There is not a single bit of proof attached to any of the
22 claims that they have filed. There are line items with
23 numbers and every one of those numbers has a footnote that
24 says estimated, subject to review; every single one.

25 I understand that the United States Government,

1 and in particular the IRS, is given the benefit of the doubt
2 in many circumstances in terms of the timing with which they
3 file pleadings and the amount of work that is put into them.
4 I understand that they are overworked and underpaid. But the
5 Internal Revenue Service is an enormous institution and it is
6 part of the Department of Treasury.

7 What we are talking about here is not particularly
8 complicated things. The bankruptcy system is put in place to
9 compel creditors to actually come to the Court with proof.
10 The bankruptcy system provides government claimants with more
11 time than regular claimants. What we have here is a case
12 that was filed in November of 2022. The Internal Revenue
13 Service has been in contact with the debtors, their
14 professionals, and Ernst & Young through the course of 2023.

15 As the declaration of Mr. Shea from Ernst & Young
16 makes clear, thousands of information discovery requests have
17 been submitted by the IRS, and responded to, and processed by
18 Ernst & Young on behalf of the debtors, thousands. We have
19 had extensive correspondence with the Department of Justice
20 on behalf of the Internal Revenue Service. We have
21 continually asked for a credible, not just credible, any
22 explanation of why the claims, the numbers that are submitted
23 with the claims, are -- how there is any support for those.
24 We have been --

25 THE COURT: I'm sorry. If you are on Zoom leave

1 Your camera off, please. If you turn Your camera on I am
2 going to remove you from the Zoom call. It's becoming very
3 distracting.

4 I'm sorry, Mr. Bromley. Go ahead.

5 MR. BROMLEY: So, Your Honor, this has been an
6 ongoing exercise, right. So we are not here looking, as the
7 Internal Revenue Service intimates in their objection, for
8 some extraordinary relief that is outrageous in light of all
9 of the unanswered discovery requests that have been
10 outstanding from the Internal Revenue Service. We have been
11 engaged in a constant dialogue. Now notwithstanding that
12 dialog we have not gotten any answers.

13 The way the system is supposed to work is that
14 creditors are supposed to file a claim. When I am
15 representing a creditor, and indeed I just worked last week
16 on a proof of claim submitted by my own firm in a bankruptcy
17 in the District of New Jersey where we have a claim because
18 we had represented the company and hadn't been paid. I am
19 focused on making sure that I am complying with the basic
20 instructions that are encompassed by the title of the
21 document which is proof of claim. I am providing the
22 information, the retention agreement, the document, the time
23 records, the invoices that we submitted that support our
24 proof of claim.

25 Now, is it different with respect to the Internal

1 Revenue Service, and, Your Honor, I submit that it's not. We
2 are all taxpayers here in the United States, right. We file
3 tax returns and until the tax return is objected to by the
4 taxing authority that is the evidence of, prima facie
5 evidence, of the amount of tax that is owed. It is incumbent
6 on the taxing authority to tell the taxpayer what is wrong
7 with the tax return, if anything.

8 This is a circumstance, Your Honor, where we are
9 have submitted all of the tax returns for '20, '21, '22. The
10 Internal Revenue Service, that is what they do, they review
11 tax returns and they decide whether or not there is anything
12 to challenge.

13 I understand that in large corporate situations
14 the strategy and the policy might be, well, we are going to
15 take our time. We are going to conduct an audit. We are
16 going to look at this information, we are going to ask for
17 things. Well, in many respects that process has taken place.
18 We have thousands of information requests that have been
19 responded to. There are a few that are outstanding and they
20 will be satisfied by January 15th. Just so Your Honor can
21 get a sense of what is outstanding, the outstanding requests
22 relate to issues like travel and food reimbursement expenses.

23 So, Your Honor, the type of information that is
24 being sought and remains outstanding is things like did they
25 really have Tabbouleh Hummus for dinner and charge for a

1 steak dinner. It's that type of backup that is the subject
2 of the requests that are outstanding. We will have that
3 information for them no later than January 15th.

4 Now, the IRS has submitted, in connection with
5 this after we filed our motion, a list of discovery requests.
6 Those discovery requests given the impression that there is
7 another enormous world of information. Well, let's look at
8 that because it relates to two different worlds.

9 The first world is we filed tax returns. The way
10 the proof of claim process works is that if you think our tax
11 returns are wrong tell us why you think they're wrong and
12 file some proof. The proofs of claim that have been filed in
13 these cases have no words, they have numbers, other than
14 estimates. We are looking at it. It doesn't say what we are
15 looking at or why we are looking at it, why we think it could
16 be this, or why we think it could be that.

17 Your Honor, one of the proofs of claim that was
18 filed by the IRS is with respect to Alameda Research LLC.
19 It's really interesting to look at because if you look at the
20 tax that is alleged with respect to the year 2022 it simply
21 takes the number from 2021 and then multiplies it by \$1.5 to
22 the penny. When you look at the numbers for 2023, the claim
23 that is alleged, they simply take the number from 2022 and
24 they multiply that by 1.5 to the penny. This doesn't show the
25 type of work or thoughtfulness that allows the debtors to

1 have any basis to object. We don't know what the claim is
2 other than the dollar amount.

3 So, Your Honor, when we are sitting here today
4 we're looking at that from the perspective of all of the
5 momentum that is moving forward to bring these cases to
6 conclusion, to be able to distribute dollars and cents to
7 victims, individuals, many of whom are on our line now and
8 have been on line for so many hearings throughout the course
9 of this case. The only way that we are going to be able to
10 implement the plan of reorganization and to start putting
11 money into the hands of these individuals is if we deal with
12 the IRS claim.

13 How big is the IRS claim in respect of our claims
14 pool? It's over 50 percent of the claims pool. When you
15 take our creditor claim -- I'm sorry, customer claims and our
16 non-customer claims and you add them together and divide it
17 by two it's the Internal Revenue Service with zero support,
18 without a word that tells us why anything that they have --
19 any number that they have alleged has a basis in fact. All
20 of our proofs that we have submitted to the internal revenue
21 service says that we have \$11 billion of losses. So, what
22 the Internal Revenue Service has to do is zero out every one
23 of those \$11 billion of losses and on top of that prove up
24 \$24 billion of cash obligations.

25 Now, in their objection the Internal Revenue

1 Service largely says, look, we need more information and it
2 could be zero, it could be \$24 billion, it could be some
3 other number. We don't have the ability within the system to
4 accommodate that kind of approach. It's not justified by the
5 law and the facts here compel a substantially different
6 answer.

7 So, what we are looking at, Your Honor, is we are
8 looking for an estimation schedule. We believe that these
9 claims are ripe, perfect for estimation. They are
10 unliquidated. Quite incredibly, the Internal Revenue Service
11 in the first sentence of their objection says that these
12 claims are liquidated because we have the information
13 somewhere in the debtors' records that would allow them to
14 calculate the number with specificity. They completely
15 ignore the fact that we have filed tax returns which say we
16 have \$11 billion of losses. We have already given them the
17 information.

18 The way this tennis game is played we hit the ball
19 over the net to them by filing a tax return, they hit the
20 ball over the net back to us by saying we have looked at Your
21 tax return and we disagree with it for these reasons. Then we
22 look at that and we hit the ball back over and say these
23 reasons don't count for these reasons and so on. We have
24 filed the tax returns. It is now their time to tell us what
25 is wrong with them. The idea that they don't have sufficient

1 information and they haven't had sufficient time is simply
2 not credible.

3 Now, Your Honor, what are we looking for? Well,
4 we are looking for something that is a timeline that is set
5 forth in our motion. We believe that by mid-January they
6 should be able to tell us, with specificity, we should be
7 able to have a process that leads us to an estimation hearing
8 in mid to late February. We believe that that is appropriate
9 under the circumstances and we completely dispute any
10 allegation that the IRS has made that there is information
11 that they need in order to take the first step. It is simply
12 not the case.

13 The way this works is we file tax returns, they
14 object to those tax returns by telling us what is wrong and
15 then we respond to those objections. We cannot bear a double
16 burden of both filing tax returns and then looking at these
17 completely naked proofs of claim which have infinity numbers
18 attached to it and then somehow try to credibly object to
19 things that we don't even know are being alleged. Now, I
20 understand that these are big cases and complicated cases and
21 I understand that the Internal Revenue Service is a large
22 organization. We happening to be dealing be the regional
23 office in Nebraska for some reason. I don't know why, and
24 I'm not criticizing it, but that's who we're dealing with.

25 This is such an enormous number. It is such an

1 obstacle to the implementation of a plan of reorganization
2 and the delivery of recovery to the victims that we need the
3 attention of more than just the office in Nebraska. We have
4 made inquiries of the Internal Revenue Service about their
5 willingness to resolve these issues in different ways. The
6 Internal Revenue Service would agree that they would
7 subordinate their claim to the creditor claims, the other
8 creditor claims, that we could have a conversation about that
9 and we've been willing to do it. They have been unwilling to
10 have that conversation.

11 We'd be willing to have a conversation with the
12 Internal Revenue Service about trying to deal with something
13 that is more rationale than a \$24 billion claim. I will note
14 that it started out as a \$44 billion claim and is now down
15 to 24. That's progress, but it's still a number that's a
16 complete obstacle to moving forward with the plans of
17 reorganization.

18 So, what we need the Internal Revenue Service to
19 do is to fit in to the system that everyone else has to
20 comply with. If we were dealing with commercial creditors
21 who were filing unsupported, unsubstantiated claims of this
22 magnitude, we would be compelled to not only move to dismiss,
23 but also to seek sanctions. Because the obstacles that are
24 being created by filing unsubstantiated, unsupported
25 outlandish claims is that we are going to create additional

1 administrative expense to fight them. That's all this is.

2 We're not asking for any of that with respect to
3 the Internal Revenue Service. We understand their role,
4 their obligations. But that doesn't mean that they have to
5 play by the rules. They have to play by the rules. They
6 have to realize that this is a case that everything that they
7 think and breathe has an impact on tens of thousands,
8 millions of creditor claims and they have to stop acting as
9 if what they do has no impact on anyone else.

10 Right now, the single largest obstacle to moving
11 forward with distributions to creditors is the Internal
12 Revenue Service and so we need a process, here in this court,
13 Your Honor, with due respect, that forces them to actually
14 engage. And the way to force them to engage is to put them
15 on a tight leash and a short schedule that forces the issue
16 to be addressed. Perhaps the way that gets addressed is once
17 that schedule gets set, we could have discussions in
18 Washington to see if there's a way to settle this.

19 But without that sort of schedule and without that
20 sort of compulsion, we're simply going to be stuck in
21 Nebraska and we can't afford to be stuck in Nebraska anymore,
22 Your Honor. Our creditors can't. The victims of Sam
23 Bankman-Fried's fraud cannot for the record to be stuck in
24 Nebraska.

25 So, Your Honor, that's where we are from the

1 debtors' perspective. We have submitted two declarations in
2 support of the motion: one of Mr. Edgar Mosley, who you have
3 seen before in court and who has testified -- he's sitting
4 here and is ready to testify if there are any concerns, so
5 we'd like to move Mr. Mosley's declaration into evidence.
6 Also in court is Mr. Thomas Shea of Ernst & Young. He's not
7 been before you, Your Honor, but he is similarly here and
8 ready to be questioned if there are any concerns, but we
9 would like to move his declaration into evidence, as well.

10 And as you see, the declarations are each for very
11 limited evidentiary purposes, but consistent with our
12 obligations to the Court, we have them here and they're ready
13 to testify, if necessary.

14 And with that, Your Honor, I would take any
15 questions the Court may have and if not, I would cede the
16 podium to my counsel -- co-counsel from the Creditors
17 Committee.

18 THE COURT: Okay. Let me see if anybody has an
19 objection to the introduction of the declarations?

20 MS. BRUCE: Yeah, we do object to the declarations
21 being entered into evidence, Your Honor. We'd ask for, at
22 least, for an opportunity to cross them.

23 THE COURT: I'm sorry?

24 MS. BRUCE: We'd at least ask for an opportunity
25 to cross the witness.

1 THE COURT: Oh, you'll have the opportunity to
2 cross if you want, yeah.

3 MS. BRUCE: Okay.

4 THE COURT: But, I mean, I can take the
5 declarations as a proffer and then I can open it up to you to
6 cross-examine the witnesses if you'd like?

7 MS. BRUCE: Okay. That's acceptable, Your Honor.

8 THE COURT: Okay. So the declarations are
9 admitted.

10 (Mosley Declaration received in evidence)

11 (Shea Declaration received in evidence)

12 THE COURT: And let's go -- we'll finish up with
13 openings here. I'll hear from the Committee and then I'll
14 hear from the Government and we'll go from there.

15 MR. BROMLEY: Thank you, Your Honor.

16 MR. PASQUALE: Good afternoon, Your Honor. Ken
17 Pasquale from Paul Hastings for the Official Creditors
18 Committee.

19 Your Honor, I'll be very brief. We find a
20 joinder. I couldn't agree more with what Mr. Bromley
21 represented, with respect to getting distributions to
22 creditors. Your Honor, you've heard me at the last number of
23 hearings saying the Committee's primary responsibility, given
24 the status of the case these days, is to expedite
25 confirmation and expedite that distribution process.

1 The IRS claim is, as Mr. Bromley explained, an
2 impediment to the timeline that's been set that, again, the
3 Committee is looking to move even faster than has been set
4 forth. I don't want to belabor the record in that regard,
5 especially with respect to an opening, Your Honor, but I will
6 mention, and Mr. Bromley quickly mentioned this as well, in
7 the plan support agreement, in the term sheet attached --
8 it's that the Docket 3291 -- the proposed plan, as you'll see
9 this weekend when the plan is filed, does provide for a
10 subordination of government claims, such as the Internal
11 Revenue Service claim.

12 There's not a mention in the IRS' opposition to
13 this motion about that issue, which is, needless to say,
14 significant in the context of the plan that will be
15 prosecuted. So I think that is a telling omission in the
16 IRS' papers.

17 But for here, I'll just ask the Court if there are
18 any questions and reserve.

19 THE COURT: No questions at this time, thank you.

20 MR. PASQUALE: Thank you, Your Honor.

21 MS. BRUCE: Good afternoon, Your Honor. Elisabeth
22 Bruce on behalf of the Department of Justice and the IRS.

23 What the debtors are asking here today is
24 essentially to circumvent the bankruptcy process and the Code
25 and what it sets out in terms of what's required to challenge

1 a proof of claim. They would like to invent additional
2 requirements that the IRS has when it filed its proof of
3 claim, additional things it should have submitted. It's --
4 those things are made up. Those things are not actual
5 requirements.

6 What the Code sets forth is what we put in our
7 brief, that when the IRS files its proof of claim, it's
8 presumptively correct and the burden is on the debtors to
9 challenge that presumption.

10 It's also very clear in case law that a tax return
11 alone is not enough to challenge an assessment by the IRS. A
12 tax return is nothing but a shell; it's a piece of piece of
13 paper with numbers on it and the debtors have the burden to
14 provide support for that tax return. That is what they would
15 use to challenge the IRS' numbers. They don't pass that and
16 that's why they're here today on their motion.

17 Now, that being said with their burden, I do think
18 it would be helpful to explain to Your Honor how the IRS came
19 up with their numbers, so I would like to just explain that
20 quickly.

21 THE COURT: Okay. Do you have a witness to
22 support this?

23 MS. BRUCE: We did not bring an IRS witness here
24 today, Your Honor. I'm happy to explain it to you myself or
25 if we could, at a later date, bring in an IRS witness, but

1 given the short deadline with their motion...

2 THE COURT: Mr. Bromley?

3 MR. BROMLEY: Your Honor, we object to any
4 explanation of what the IRS did or didn't consider, unless
5 there's a witness available to be cross-examined.

6 THE COURT: That's right.

7 I've got to have it evidence. I can't -- you
8 can't testify.

9 MS. BRUCE: Okay. Understood, Your Honor.

10 So the debtors have not provided the support or
11 substantiation to change the IRS' claim. They have claimed
12 that E&Y has been working on this and that they have provided
13 thousands of responses to the IRS. Those expenses have
14 included such things as saying, We don't have support. So
15 they said, We've responded, but they have not provided
16 support.

17 The debtors are trying to distance themselves from
18 all of their prior filings in this case, from John Ray's
19 reports and saying, Oh, it was a year ago that they said
20 there were no books and records, that there were no corporate
21 controls. And they're now asking us to somehow believe that
22 John Ray's group has completely reorganized the company, such
23 that even prior information is now reliable.

24 We noted in our brief, even E&Y doesn't believe
25 the prior year's tax returns. They noted in there when they

1 filed their 2022, that, essentially, they couldn't have
2 signed 2022 tax returns if they were relying on the prior
3 year's tax returns at all. So, E&Y wants to stay an arm's-
4 length away from these prior returns, but wants the IRS to
5 accept them as face value and just take the numbers as they
6 are with no substantiation behind them whatsoever.

7 I think it's also very telling in Mr. Shea's
8 declaration that the responses they list, not one of them
9 include anything for the 2022 tax returns. Now, the IRS has
10 not issued official IDRs for those, but they have been in
11 contact with E&Y.

12 I personally spoke with Mr. Shea and asked him to
13 provide support for that, given the emphasis from both, the
14 debtors and us, on speed and to prioritizing -- to prioritize
15 providing that information. The IRS has not received any
16 support whatsoever for those 2022 tax returns, which EY filed
17 in August. They knew very well in August that the IRS was
18 auditing them and that information would be necessary. It
19 has not yet been provided.

20 The timeline that the debtors are suggesting here,
21 first of all, estimation, we don't believe is even
22 appropriate in this case, Your Honor. Estimation hearings
23 are appropriate when the claim is difficult to quantify.
24 When you're dealing with something like emotional distress,
25 that it's like, how can anybody even assign a value to that.

1 We're dealing with numbers here. We're dealing with taxes.
2 We're dealing with income taxes, employment taxes; these are
3 numbers that can be calculated. We don't have to ask
4 somebody to assign a value to them. They can be calculated.

5 The problem is that the debtors don't have the
6 support they need. That's a different problem. That doesn't
7 mean estimation is appropriate here.

8 Even if Your Honor finds that estimation is
9 appropriate, the deadlines that they're proposing is somewhat
10 preposterous. EY filed these returns in August and has yet
11 to provide the support. It's taken them months to work on
12 it, but the debtors think they can give us 21 days to do all
13 of our discovery, review all of that support, conduct
14 depositions, do a 30(b)(6) of EY; all of that, they think we
15 only need 20 days for.

16 There's no reason for this emergency. It's
17 completely fabricated by the debtors. If they wanted to deal
18 with the IRS claim, they could have done it when the IRS
19 filed any time April.

20 If they wanted to present Your Honor with nothing
21 more than tax returns with no support, they had those tax
22 returns in August. Why didn't they file something in August?

23 The claims bar deadline was at the end of
24 September. If they wanted to wait until then, they could
25 have filed something in September.

1 Now they choose to file this motion a week before
2 their proposed plan and their own self-imposed deadlines and
3 say that because of that, because of the plan support
4 agreement, which we weren't a party to, which they did not
5 bring us in on, because of all of that, they need this
6 impossibly rushed and truncated schedule that deprives us of
7 the opportunity to actually litigate this claim.

8 If Your Honor wants to move this along, we'd
9 suggest that you give the debtors a deadline and say, You
10 know what, in 21 days, EY needs to provide the rest of what
11 is owed to the IRS.

12 And what's owed, Your Honor, all the support for
13 2022, all the support. They filed those returns.

14 Some partner must have been looking at support
15 when they signed his name on that return. Where is that
16 support? We have not been provided it. They should give
17 that to us.

18 What else should they give us? EY has told the
19 IRS that they will not support the prior year's tax returns.
20 So they have three options. They can tell the IRS, We don't
21 support for them, so do what you will with them or they can
22 amend them or they can say, You know what? Those returns are
23 good. We'll sign them. We'll support them. Do one of those
24 things and then tell the IRS: We're done.

25 So if they had spent this enormous amount of work

1 that they say they have -- and I'm not disparaging EY, I know
2 that it's an unprecedented situation with the company -- but
3 they need to give the IRS a finite universe of information.
4 The reason it's taken so long is because the IRS makes a
5 request, they give them a lot of time. They come back, they
6 say, Oh, well, we only gave you what you asked for. You
7 haven't asked for 2022 support yet, because the returns
8 haven't technically been processed, all of those
9 technicalities.

10 Let's do away with the technicalities. Let's tell
11 the debtors, You know what? You're touting your returns so
12 highly, give the IRS all the support for them and tell them
13 when you're done. Tell them when you've given them
14 everything you've got. And then from that date, from the
15 date they tell us they're done, give us at least three, four
16 months to review it and then we'll come and we'll have a
17 hearing on it.

18 But to come up and say, you know, it's on the IRS
19 to come and put forward all of their information when EY has
20 not provided all the support for it. It is just flipping
21 everything on its head, Your Honor. It's misrepresenting who
22 has the burden here. It's misrepresenting who has the
23 ability to provide the information.

24 This is a one-way street. It's always that case.
25 When a tax return is filed, the taxpayer has all the

1 information. It's on them to provide that information to the
2 IRS. It's not on the IRS to make up a number. So --

3 THE COURT: But isn't that what you did? Where
4 did the \$24 billion come from?

5 MS. BRUCE: Well, it started with the tax returns
6 filed by the debtors and they've made adjustments based on
7 the lack of information that they've received.

8 So that's what I was going to attempt --
9 basically, Your Honor, it's based on what they found in the
10 pleadings, which relates to misappropriation of income and
11 underreported income and --

12 THE COURT: But how do you know that? How do you
13 know it's underreported?

14 MS. BRUCE: It was in the filings, Your Honor, the
15 fact that they had no books and records. The company was
16 rife with fraud. They were stealing money, so they were
17 taking cash from customers, reporting it as deposits, and
18 using it to run the business.

19 THE COURT: So you're assuming --

20 MS. BRUCE: That's deposits, not income.

21 THE COURT: -- you're just making assumptions?

22 MS. BRUCE: Well, those were facts that were filed
23 with this Court, Your Honor.

24 THE COURT: What facts?

25 MS. BRUCE: In John Ray's report.

1 THE COURT: All they're saying is there was fraud
2 in the company and somehow that turns into a \$24 billion tax
3 claim.

4 MS. BRUCE: It's the application of those facts to
5 their tax returns, to the ones that they had that were filed,
6 and then they did have to make estimates for later years. At
7 the time, they didn't have any tax returns for 2022 --

8 THE COURT: All right.

9 MS. BRUCE: -- in April.

10 So, essentially, Your Honor, EY doesn't trust the
11 returns. Everyone has said the company doesn't have books
12 and records, that it was a fraud. But the debtors think that
13 the IRS should be forced to accept nothing but a single page
14 of a tax return and say, This is gospel. But when you ask --
15 when the IRS asks for support, we don't have it, but you
16 should just take this as gospel.

17 When they know that the IRS is going to be
18 auditing those returns and they have months to provide that
19 support, they don't do it, but we're just supposed to take
20 that tax return in and accept it. I think that expectation
21 of the IRS is preposterous and they're expecting treatment
22 that no other taxpayer would get.

23 And they know that. They put in their pleadings,
24 they complain that they're being treated like every other
25 taxpayer; that's their complaint in their pleading.

1 We're treating them like every other taxpayer; we
2 are expecting them to substantiate their tax returns. So if
3 that's their biggest complaint, then that is what the IRS has
4 done. The IRS does expect them to substantiate.

5 THE COURT: Okay.

6 MS. BRUCE: So we would ask that you deny their
7 motion, Your Honor. To the extent you find an estimation
8 hearing is appropriate, we would ask that you would approve a
9 schedule, similar to what we propose, where you give them a
10 deadline to provide us information and then provide us a
11 reasonable amount of time to review it and to prepare for a
12 hearing.

13 THE COURT: All right. Thank you.

14 MS. BRUCE: Thank you.

15 THE COURT: Do you want to cross the witnesses?

16 MS. BRUCE: Mr. Shea, we would like to cross, yes.

17 THE COURT: Okay. Mr. Shea, do you want to step
18 forward, please.

19 Can you please come forward, take the stand, and
20 remain standing for the oath.

21 THE CLERK: Please raise your right hand.

22 Please state your full name and spell your last
23 name for the record, please.

24 MR. SHEA: Thomas Michael Shea, S-h-e-a.

25 THOMAS MICHAEL SHEA, DEBTORS' WITNESS, AFFIRMED

1 THE WITNESS: Yes.

2 THE CLERK: You may be seated.

3 Your Honor?

4 THE COURT: Okay. Go ahead.

5 CROSS-EXAMINATION

6 BY MS. BRUCE:

7 Q Good afternoon, Mr. Shea.

8 A Good afternoon.

9 Q What is your current place of employment?

10 A Ernst & Young, LLP.

11 Q And what's your role there?

12 A I am a principal in our tax practice.

13 Q Mr. Shea, do you recall having a phone conversation
14 with me and David Harrington from Sullivan & Cromwell in
15 October?

16 MR. BROMLEY: Objection, Your Honor.

17 Mr. Shea's declaration is the direct testimony.
18 Anything that's outside of the four corners of the
19 declaration are outside the scope of cross.

20 THE COURT: Can you -- I don't know if we're
21 picking you up on that one.

22 MR. BROMLEY: I'm sorry, Your Honor.

23 James Bromley of Sullivan & Cromwell.

24 The appropriate subject for cross-examination is
25 the declaration, which forms his direct testimony, so we'd

1 ask that the IRS focus on the declaration. The idea that
2 she's going to ask questions about a conversation that she
3 had with Mr. Shea is certainly not within the four corners of
4 the declaration.

5 MS. BRUCE: Your Honor, it does go to how E&Y has
6 been responding to the IRS, what they've been aware of, and
7 what responses they have provided.

8 THE COURT: But you're going to --

9 MR. BROMLEY: Objection for lack of foundation,
10 Your Honor.

11 THE COURT: But you're going to ask him questions
12 about a conversation he had with you?

13 MS. BRUCE: Yes, Your Honor.

14 I would like to know whether -- it goes to whether
15 he was aware of information that the IRS needed.

16 THE COURT: Then, doesn't that make you a witness?

17 Because if you're going to ask him that question,
18 I'm going to let him cross-examine you, which means you can't
19 argue this case.

20 MS. BRUCE: Okay. Then I can you the question,
21 Your Honor.

22 THE COURT: Okay.

23 BY MS. BRUCE:

24 Q Mr. Shea, do you have your declaration available?

25 A I do over in my seat.

1 Q Okay.

2 MS. BRUCE: If we could get you a copy of it?

3 MR. BROMLEY: Your Honor, may I approach?

4 THE COURT: Yes.

5 BY MS. BRUCE:

6 Q If you could look at paragraph 6 of your declaration,
7 Mr. Shea, in this paragraph, you summarize the requests that
8 E&Y has received from the IRS; is that correct?

9 A Yes.

10 Q In the table that you list here, are any of these
11 requests related to the 2022 year for income tax?

12 A No.

13 Q Has E&Y provided any support to the IRS for the 2022
14 tax years?

15 A No.

16 Q Have -- has the IRS asked you for support for the 2022?

17 A Not through an additional IDR.

18 Q Have they asked you informally?

19 A Yes.

20 Q Have you been working with them to provide that support
21 for 2022?

22 A Yes.

23 Q How long have you been working with them to provide
24 that support?

25 A Specifically, over the last few weeks.

1 Q When do you anticipate being able to provide them that
2 support?

3 A Friday, December 15th.

4 Q And what support is it that you will be providing on
5 that date?

6 A It will be document requests that are similar to what
7 we have provided for the previous taxable periods.

8 Q Will it include support for the losses claimed on the
9 turns?

10 A Yes.

11 Q Will it include support for the expenses claimed on the
12 tax returns?

13 A Yes --

14 Q Will --

15 A -- to the extent there are expenses we can support,
16 yes.

17 Q Are there expenses on the tax return that you are
18 unable to support?

19 A I'm -- I don't remember. I don't recall all the
20 details of that.

21 Q So you're not sure if there are expenses there that
22 will be unsubstantiated?

23 A I believe if there were expenses that were
24 unsubstantiated, we have already considered that in the filed
25 returns.

1 Q Okay. But it is true that, as of today, the IRS has
2 not received any support for the 2022 tax returns?

3 A That is correct.

4 Q In regards to the 2021 and 2020 tax returns, has E&Y
5 signed off on those returns in any way?

6 A We have not been asked to sign off on the returns. We
7 have assisted with the compilation of information to provide
8 to the IRS.

9 Q Does E&Y believe that those returns are accurate?

10 A We believe that there are, potentially, adjustments in
11 those returns.

12 Q So you believe that the returns do need to be amended?

13 A Amended or adjusted through the audit process, yes.

14 Q Is there support that the IRS requested for those
15 returns that E&Y has been unable to provide?

16 A Some questions we have been unable to provide support
17 for.

18 Q What type of request?

19 A I don't recall offhand.

20 Q I have an example of one that I can provide you.

21 MS. BRUCE: May I approach?

22 THE COURT: Yes.

23 Do you have a copy for me? Thank you.

24 BY MS. BRUCE:

25 Q Mr. Shea, if you could take a moment and look at this

1 document and let me know if you recognize it.

2 A I do, yes.

3 But I, admittedly, I -- you know, we have a team full
4 of professionals that are involved with compiling all of this
5 information.

6 Q Is John Healy, who has signed this return, is he on
7 your team as E&Y?

8 A Yes.

9 Q And he's working on the FTX audit?

10 A Yes.

11 Q This, at the top here, it says, "FTX response to IRS
12 information document request."

13 So is it accurate to say that this document is a
14 response that your team at E&Y provided to the IRS?

15 A Yes.

16 Q Could you please turn to the third page of the document
17 I just provided you, and could you read the response under
18 number 16. Could you read the title of number 16, what was
19 asked for, and then the response.

20 A "See response 11. Invoices for business expenses were
21 not stored in any centralized location and are unavailable."

22 Q And the request, what number 16 was asking for, the
23 description of that, could you read that.

24 A "Details and substantiation for all expenses."

25 Q So, is it fair to say that the IRS requested

1 substantiation of all expenses and in response to that, your
2 team said that the expenses were not stored in a centralized
3 location and are unavailable.

4 Is that an accurate representation?

5 A Yes.

6 And this is with respect to, specifically, the entity,
7 Alameda Research, LLC.

8 Q And that's if you look in the upper left-hand corner of
9 this document, correct --

10 A Yes.

11 Q -- you see "Alameda Research"?

12 A Yes.

13 Q And the date on this response, what was the date?

14 A November 30th, 2023.

15 Q I don't know, do you have any idea when the debtors
16 filed their motion in this case that we're here on today?

17 A I believe it was shortly after.

18 Q Since November 30th, 2023, do you have any reason to
19 believe that this response has changed?

20 A I do not.

21 Q So as of today, if you were asked to substantiate the
22 expenses for Alameda Research LLC, E&Y's response would be
23 that they have no support; is that correct?

24 A Yes.

25 Q I also have excerpts of the 2022 tax return that E&Y

1 prepared.

2 MS. BRUCE: If I could approach, Your Honor?

3 (No verbal response)

4 THE COURT: Thank you.

5 BY MS. BRUCE:

6 Q Mr. Shea, do you recognize this document?

7 A Yes.

8 Q What is it?

9 A It is the 2022 tax return for Alameda Research LLC.

10 Q And this tax return was prepared by your firm E&Y,
11 correct?

12 A Correct.

13 Q If you could flip to, I believe it's about eight pages
14 in, and on the lower right-hand corner of the document, it
15 says "statement 16."

16 A Yes.

17 Q Could you just take a moment to read this so I can ask
18 you a question about it.

19 A Yes.

20 Q This is a footnote that was included in the 2022 tax
21 return that your firm filed, correct?

22 A Correct.

23 Q Does this footnote say that none of the prior year net
24 operating losses were being utilized for 2022?

25 A Correct.

1 Q If the 2022 tax return had utilized the prior year net
2 operating losses, would you have signed the tax return?

3 A I can't say we didn't deal with that situation.

4 Q What was the purpose of including this footnote in the
5 tax return?

6 A It was to alert of basically what I declared that we do
7 anticipate possible adjustments to prior year returns.

8 Q If you could flip one more page over, Mr. Shea, this is
9 the beginning of several pages of support here. Do you
10 recognize this --

11 A Yes.

12 Q -- schedule? Is this a schedule that was included in
13 the 2022 tax return?

14 A Yes.

15 Q And is it the support for the capital loss that was
16 claimed on the 2022 tax return for Alameda?

17 A It is a summary of the losses.

18 Q On the right-hand column where the heading says
19 proceeds, slash, basis, right underneath that, could you read
20 me what it says right below that?

21 A Further details available upon request.

22 Q Has the IRS requested these details?

23 A Yes.

24 Q Have they been provided?

25 A We have started previewing that information on some of

1 the weekly calls with them. So we've gone through the format
2 to make sure that it's everything that they're looking for
3 and we're working with them on a way of transmitting that
4 data because it is rather substantial.

5 Q But, I'm sorry, just to pinpoint your answer, that data
6 has not been provided to the IRS; correct?

7 A It has not yet.

8 Q Okay.

9 MS. BRUCE: Your Honor, I'd like to move the
10 information document request in as Exhibit 1 and the excerpts
11 of the tax return in as Exhibit 2.

12 THE COURT: Any objection?

13 MR. BROMLEY: We would say the entire tax return
14 rather than excerpts of it.

15 THE COURT: I'm sorry?

16 MR. BROMLEY: Your Honor, the entire tax return
17 rather than excerpts.

18 THE COURT: Do we have the entire tax return?

19 MR. BROMLEY: Well, the entire document that has
20 been provided.

21 MS. BRUCE: I didn't print out copies of the
22 entire tax return, Your Honor, I can --

23 MR. BROMLEY: So these are just the --

24 MS. BRUCE: -- provide it electronically.

25 MR. BROMLEY: So these are the excerpts that

1 you're seeking, the ones that we have in our hands?

2 MS. BRUCE: Those are just the excerpts that we're
3 seeking to introduce.

4 MR. BROMLEY: So the question, the entire document
5 I have in my hand is what you're seeking to --

6 MS. BRUCE: That's correct.

7 MR. BROMLEY: -- move in?

8 MS. BRUCE: Yes.

9 MR. BROMLEY: Okay. We don't have an objection to
10 that, Your Honor.

11 THE COURT: Okay, they're both admitted without
12 objection.

13 (IRS Exhibits 1 and 2 received in evidence)

14 MS. BRUCE: I have no further questions at this
15 time, Your Honor.

16 THE COURT: Okay, thank you.

17 Redirect?

18 MR. BROMLEY: Your Honor, I just have a few
19 questions.

20 REDIRECT EXAMINATION

21 BY MR. BROMLEY:

22 Q Mr. Shea, so the question that Counsel for the IRS
23 asked you about further details available upon request,
24 that's the information you're going to provide on Friday?

25 A That's correct.

1 Q That's two days from now, right?

2 A Yes.

3 Q And the information requests that are outstanding with
4 respect to the 2022 tax year, I think you mentioned that they
5 were not the subject of official IDRs?

6 A That's correct.

7 Q So, notwithstanding the lack of official IDRs, Ernst &
8 Young has been complying with informal requests to produce
9 materials, correct?

10 A Correct.

11 Q And that's going to be produced on Friday?

12 A Yes.

13 Q Now, Ernst & Young has reviewed the tax returns for
14 2020 and 2021, correct?

15 A Correct.

16 Q And the -- what is the dollar amount of the losses
17 relating to the tax years 2020, 2021, and 2022?

18 A In total, about \$11 billion.

19 Q And the question that was asked to you with respect to
20 the Alameda Research set of questions, do you recall that --

21 A Yes.

22 Q -- Mr. Healy's document? Item 16, detail of the
23 substantiation for all expenses, do you see that?

24 A Yes.

25 Q Yeah. How many -- with respect to the business

1 expenses for these debtors that relate for this debtor,
2 Alameda Research, has Ernst & Young calculated them in the
3 billions of dollars?

4 A No.

5 Q Can you give a ballpark of what the business expenses
6 are?

7 A It's tough to estimate. I mean, if we go off what's in
8 2021, I mean, there's about 34 million.

9 Q About 34 million?

10 A Yes.

11 Q Not billion?

12 A Right, in -- yes -- I'm sorry, in 2022, the return I'm
13 looking at.

14 Q And the corporate tax rate that's applied to Alameda
15 Research, LLC?

16 A Twenty one percent.

17 Q Twenty one percent? So if \$34 million of business
18 expenses were reclassified as taxable income, you'd apply a
19 21-percent interest rate to that? So 21 percent of \$34
20 million is how many billions?

21 A It's a couple million --

22 Q A couple million?

23 A -- about six, six and change.

24 Q Thank you.

25 Now, there was a reference in the earlier testimony

1 about potential adjustments, do you anticipate that any
2 potential adjustments will have a material impact with
3 respect to creating incremental additional tax liabilities
4 for the debtors?

5 A No.

6 MR. BROMLEY: Thank you, Your Honor, I don't have
7 any further questions --

8 THE COURT: Okay, thank you.

9 MR. BROMLEY: -- for Mr. Shea.

10 THE COURT: Thank you, Mr. Shea. You may step
11 down.

12 THE WITNESS: Thank you.

13 THE COURT: Any other evidence?

14 MR. BROMLEY: No further evidence from the
15 debtors, Your Honor.

16 MS. BRUCE: Not from us, Your Honor.

17 THE COURT: Okay. The openings were kind of
18 argument, but does anybody want to make some final comments
19 before we finish up?

20 MR. BROMLEY: Very briefly, Your Honor. We think
21 that this is additional evidence of the compelling need to
22 move this exercise forward and with dispatch.

23 The Internal Revenue Service has it backward.
24 These have -- the idea that a taxpayer files a tax return and
25 the Internal Revenue Service has the ability to ask endless

1 questions about irrelevant issues while asserting claims that
2 are literally to infinity and beyond simply have no
3 credibility.

4 There are two processes that we're talking about
5 here, one is dealing with taxpayer process and the other is
6 talking about bankruptcy process. The Bankruptcy Court is
7 the place where those two processes come together for a
8 practical solution.

9 Now, the Internal Revenue Service says that this
10 is a motion for estimation. Well, Your Honor, we could have
11 simply filed a motion -- the equivalent of a motion to
12 dismiss. Once a proof of claim is filed, yes, it is deemed
13 valid until objected to. There is no basis for these claims,
14 zero. The idea that -- we need to move the process forward.
15 So whether we refer to this as an estimation proceeding or a
16 motion to dismiss for failure to state a claim is kind of
17 irrelevant. We need to have a process to come to a
18 conclusion. That conclusion needs to be obtained quickly, so
19 that the victims of Sam Bankman-Fried's fraud can be
20 compensated and receive payment.

21 The Internal Revenue Service has decided, in its
22 wisdom, to simply put numbers which have no basis in fact and
23 those numbers are so large, so astonishingly large, that it
24 creates a complete obstacle to moving forward with a plan of
25 reorganization. It can't happen, it can't be allowed. We

1 can't have a situation where the Internal Revenue Service is
2 allowed in its own bureaucracy to hold up the movement
3 forward of these cases, and they need to be able to be
4 brought in front of this Court and have a credible, logical
5 objection to what the debtors have put forward. The Internal
6 Revenue Service has none. They've made some allegations
7 about misappropriation, this or that.

8 Your Honor, I don't know of any American taxpayer
9 that could owe \$24 billion. I don't know if you took Apple
10 and Tesla and Amazon all together if they were going to have
11 to pay that sort of amount of money for taxable profits
12 earned in the United States over the past four years. I
13 doubt it.

14 And, you know, the questions that have been asked
15 is -- you know, go to completely irrelevant issues. The
16 magnitude of their claim -- if they were sitting here today
17 and had a \$5 million claim or a \$10 million claim, we
18 wouldn't be asking for this kind of expedited treatment
19 because it's something that could be worked through and dealt
20 with in the process.

21 The sheer size of their claim is the reason why we
22 have to deal with it on an expeditious basis. So the
23 rationale that they use to say that we shouldn't be moving
24 forward fast is exactly the reason why we have to. And, you
25 know, it is disappointing that there is no explanation

1 whatsoever. And even with Ernst & Young on the stand, the
2 only thing that we can point to is a failure to back up some
3 expenses that might add -- you know, yield to a 21-percent
4 tax on \$34 million of expenses that can't be supported. You
5 know, if that's what we need to do to deal with a claim of
6 that magnitude, sure, we can deal with that, but to sit here
7 and try to imagine how one would say \$24 billion is the wrong
8 number, you know, is simply -- it's simply not anything that
9 we, the debtors and the creditor constituency, should have to
10 bear. The Internal Revenue Service has to say why they think
11 the tax returns are wrong and why they think any dollar
12 amount of taxable income exists and taxes are owed on it.

13 We have filed tax returns which show \$11 billion
14 worth of losses. The Internal Revenue -- it's supported by
15 tax returns prepared by one of the leading tax preparers and
16 experts in crypto-tax in the world, and the fact that they
17 haven't signed on to two years of tax returns that were
18 prepared by other accountants is self-evident. But have they
19 provided the backup and support? Yes. And did they feel
20 that there are adjustments? Perhaps. Will those adjustments
21 have any material impact on the tax profile of these debtors?
22 No.

23 The fact is, is that that's the evidence here
24 today, that will be the evidence in February. And if the
25 Internal Revenue Service wants to put something else out

1 there that we can respond to, this is the time to do it, and
2 we believe the schedule that we have proposed is the
3 appropriate schedule under the circumstances.

4 Thank you, Your Honor.

5 THE COURT: Thank you.

6 Mr. Pasquale? Let me have Mr. Pasquale first.

7 MR. PASQUALE: Thank you, Your Honor, Ken Pasquale
8 for the committee, very quickly.

9 Counsel mentioned in her opening that the way the
10 IRS views the schedule for litigation is it should be that
11 E&Y turns over some information on behalf of the debtors and
12 then, three to four months later, the IRS will get back to
13 us. Well, Your Honor, by that stage in these cases, we
14 should be really at the finish line, not starting, and that's
15 just unacceptable.

16 The other comment I just wanted to respond to,
17 Your Honor, is this is not like any other situation that the
18 IRS deals with. This is not just the IRS and the tax filer,
19 this is a bankruptcy debtor, and this is not a two-party
20 dispute, there are all of the creditors of these estates who
21 this issue, this is a gating item for their recoveries. And
22 so, Your Honor, this is not the situation where the IRS can
23 treat this like any other situation.

24 And so we fully support the motion and ask the
25 Court to impose the schedule that's proposed by the debtors.

1 Thank you, Your Honor.

2 THE COURT: Thank you.

3 Ms. Bruce?

4 MS. BRUCE: Yes, thank you, Your Honor.

5 The evidence today here has shown that there is
6 significant gaps and lack of support for what the debtors are
7 saying they've given the IRS. Now, they say it's irrelevant,
8 but I don't think all the support for the 2022 tax returns is
9 irrelevant, I don't think the support for all the expenses
10 claimed on the 2021 and 2020 tax returns is irrelevant. Any
11 other taxpayer would have to substantiate those returns, it
12 is very relevant. And the fact that the debtors can't
13 provide it, it's just further evidence that they're here
14 trying to turn the tables and get away from the fact that the
15 burden is on them to support their tax returns.

16 The Bankruptcy Code follows the tax law and the
17 debtors are trying to get away from that. The estimation
18 hearing they're asking for is the incorrect venue for that.
19 All that the estimation hearing would do is need to follow
20 the tax code.

21 Now, they've brought up other issues about there
22 being victims here, which we are aware of, about
23 subordination being possible, estimation is not the right
24 venue for that. If they want to address those issues, they
25 could have asked for a mediation or some other avenue, or

1 productively engaged with us in negotiations rather than just
2 saying you guys are either at the bottom of our plan or we're
3 not going to talk further. So that is not -- the fact that
4 there are victims here is not a reason to hold an estimation
5 hearing, Your Honor.

6 And I think it's very clear that they have not
7 been able to support and meet their burden, and we would ask
8 that you deny their motion on that basis. And in the event
9 you grant it, provide a reasonable schedule which at least
10 gives the IRS a finite universe of data, in other words,
11 gives the debtor a deadline to finish what they need to do,
12 provide the support -- they say adjustments need to be made,
13 make the adjustments, amend the returns, and then set
14 deadlines from that point.

15 And the IRS is not holding up distributions. The
16 debtors make it sound like checks would be going out the door
17 tomorrow if it weren't for us; that's not the case. This is
18 not an emergency situation. There's an entire claims
19 resolution process that needs to be got through, checks are
20 not going to go out tomorrow if you make our claim zero, Your
21 Honor. So we respectfully ask that you deny their motion.

22 THE COURT: Okay, thank you.

23 All right, I'm going to take a short recess, and
24 then I'll come back and give you my ruling on this. Let's
25 recess until 2:30 and we'll come back.

1 Thank you.

2 (Recess taken at 2:16 p.m.)

3 (Proceedings resumed at 2:33 p.m.)

4 THE COURT: Thank you. Please be seated.

5 All right. There are three questions, actually,
6 before me today, first is whether or not the IRS's claim is
7 subject to estimation under 502(c); two, if it is, what
8 schedule should be imposed for that estimation; and, three,
9 who bears the initial burden of proof at any estimation
10 hearing that might be.

11 On the first question of whether or not estimation
12 is allowed of an IRS claim, I find that it is. 502(c) allows
13 for the estimation of any claim that is unliquidated or
14 contingent. The IRS's proof of claim is based on estimates
15 only, it is not a solid number, and the testimony I heard
16 today was there's no real basis to make that determination at
17 this point in time.

18 A number of courts have held that in situations
19 where the IRS has filed just an estimate of taxes it is
20 subject to a determination through an estimation process.
21 For example, Revco, D.S., Inc., 131 B.R. 615, 621 (Bankr.
22 N.D. Ohio 1990), determined that debtors could challenge the
23 IRS's estimate of prepetition taxes through either 505 or
24 through 502(c).

25 Also, In re Matter of Carr, 134 B.R. 370 at 373

1 (Bankr. N.D. Nebraska 1991), came to the same conclusion.
2 And also In re Southern Commodity Corp., 62 B.R. 4 at 6
3 (Bankr. S.D. Florida 1986), same conclusion.

4 Therefore, I find that the IRS's claim, because it
5 is based only on estimates, it is subject to an estimation
6 process under Section 502(c).

7 The next question then is, what's the schedule
8 going to be. The debtors have submitted their proposed
9 schedule, the IRS has requested an additional five to six
10 months -- or four to five months on top of that.

11 As the debtors point out, bankruptcy requires
12 that -- well, bankruptcy is a process that moves quickly and
13 it requires that a debtor -- the debtor here has already been
14 in bankruptcy for over a year and it's a complicated case,
15 obviously, there are complicated issues with trying to pull
16 together the information that was not available when the case
17 was first filed, and the debtors have been working diligently
18 trying to gather that information. So, in that vein and with
19 a need to get this -- and mindful always of the fact that it
20 is the customers and the creditors here who need to get paid.
21 And I understand the IRS is a creditor as well, but because
22 of the size of the claim, \$24 billion estimated, it has an
23 impact on the ability of the debtors to move forward with
24 this case.

25 Therefore, I'm going to modify it only by adding

1 two weeks to the proposed schedule, so all the dates should
2 be moved out two weeks, that's both to give the IRS a little
3 bit more time and to accommodate the Court on its calendar as
4 well.

5 I don't know when the debtors are planning on
6 setting a hearing on their confirmation, I don't know whether
7 there will be objections to confirmation, there may be, but I
8 have held hearings in late 2022, right around the time this
9 case was getting filed -- no, it was 2021 -- in Mallinckrodt,
10 one case I held -- ended up with six weeks of trial time for
11 confirmation and to hold in between, right in the middle of
12 that, a two-week trial on whether or not the debtors had a
13 post-petition claim against them for antitrust violations.
14 So it can be done, it's not unusual, it's not unheard of.

15 And as far as a date for the hearing, I'd ask the
16 parties to confer with chambers to get a date for the hearing
17 within that -- again, that two-week extension of time.

18 On the burden of proof issue, I'd like the benefit
19 of a little bit more briefing on that issue because it is an
20 important issue and one that I want to make sure I'm making
21 the right decision. So I'm going to ask the parties to make
22 simultaneous filings, briefs, short briefs, no more than ten
23 pages, addressing the question of, as between the IRS and the
24 debtors, who has the initial burden of proof at the
25 estimation hearing. And I'll let you meet and confer and

1 come up with a date, given the holiday season, so that
2 everybody can be accommodated as to when those will be
3 submitted.

4 And I want to make sure the parties understand and
5 keep in mind, estimation is not a determination of the
6 liquidated value of the claim, it can't be, and it's a
7 summary process. It is not a full-blown evidentiary process
8 where parties can request all kinds of discovery and take all
9 kinds of depositions and bring in all kinds of expert
10 witnesses. So I'd like to get some sense from the parties,
11 given that I've now ruled that it can be estimated, as to
12 what this process is going to look like, what do the parties
13 anticipate.

14 I saw something in the papers, both sides saying
15 we might not even need expert witnesses, it might be able to
16 be decided on a question of law; if there are facts, they're
17 easily determined. You know, for example, I heard the
18 testimony today about the deductions for business expenses
19 and, you know, that there's at least some evidence at this
20 point that as for 2022 it might only be \$34 million. And if
21 that's true, given the \$24 billion claim filed by the IRS, it
22 would seem that it would be easier to determine factually
23 that even if there's information missing, it's not going to
24 change the number because you're never going to get to a
25 point where the debtors are going to owe \$24 billion in

1 taxes. It might not get to a point where the debtors owe any
2 taxes, it might be they owe a little bit of taxes, it might
3 be they owe a few million dollars or tens of millions of
4 dollars.

5 I don't know at this point because I don't have
6 the benefit of the evidence, but it would seem the parties
7 could look at the evidence ahead of time and make that
8 determination without having to spend the time and effort to
9 come to a trial and spend a week or two going through tons of
10 tax information to determine the value of the claim. It
11 might not be necessary to do that; if the missing information
12 doesn't rise to a level where the debtors actually owe taxes,
13 that's the end of the story. So let's look at that as we're
14 going through the discovery process here and keep that in
15 mind.

16 I mean, the idea here in bankruptcy -- we're not
17 in Tax Court -- so in bankruptcy we're trying to get to
18 conclusions quickly and be as accurate as possible without
19 wasting a lot of time and resources of the estate or the
20 other party, the creditors. So let's keep that in mind.

21 Now, give me some thoughts. I'd like to -- when
22 is the next omnibus hearing in this case?

23 UNIDENTIFIED SPEAKER: January 25th, I believe,
24 Your Honor.

25 THE COURT: Okay, let's set up something before

1 that. Contact chambers, see if we can get a date the second
2 week of January for a status conference to see where we are
3 on that issue, what this hearing is going to look like.
4 Hopefully, by then I will have the benefit of the briefing.
5 Maybe I don't, it depends -- the additional briefing, it's up
6 to you guys. If I do have that briefing, we'll talk about
7 that at that status conference, but otherwise let's talk
8 about what this estimation hearing is going to look like when
9 we get there.

10 Any questions, comments, concerns?

11 MR. BROMLEY: None from us, Your Honor.

12 THE COURT: All right. Anything else before we
13 adjourn?

14 MR. LANDIS: That's it for the debtors, Your
15 Honor.

16 THE COURT: Okay. Anything?

17 MS. BRUCE: Nothing from us, Your Honor.

18 THE COURT: Okay, thank you.

19 Thank you all very much. I appreciate the
20 presentations, it was very helpful for me, and I will see
21 everybody sometime in early January. Have good holidays.
22 Thank you.

23 COUNSEL: Thank you, Your Honor.

24 (Proceedings concluded at 2:42 p.m.)

25

CERTIFICATION

We certify that the foregoing is a correct transcript from the electronic sound recording of the proceedings in the above-entitled matter to the best of our knowledge and ability.

/s/ William J. Garling

December 14, 2023

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Certified Court Transcriptionist
For Reliable

/s/ Tracey J. Williams

December 14, 2023

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December 14, 2023

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